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Real Property

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REAL PROPERTY

*J. Richard White**
*G. Roland Love***

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THIS Article covers cases from 289 S.W.3d through 314 S.W.3d, and federal cases during the same time period, which the authors believe are noteworthy additions to the jurisprudence on the applicable subject.

I. INTRODUCTION

There were no substantive changes in real property law in the areas of debtor/creditor relationships, guaranties, leases and landlord/tenant relationships, or in the more traditional areas relating to conveyances, other title matters and related miscellaneous property rights. But, there were a few cases which deserve mention for various reasons. In particular, there are significant decisions involving assignment of rents, rights of first refusal and correction deeds.

II. MORTGAGES, LIENS AND FORECLOSURES

A. USE OF INSURANCE PROCEEDS

Keith's home mortgage had a casualty provision providing that "[Mortgagee] may apply any proceeds received under the insurance policy either to reduce the note or to repair or replace damaged or destroyed improvements covered by the policy."[1] The outstanding balance on the mortgage debt was $22,600, but the casualty caused $25,000 in damages. An insurance company check, payable to Keith, her attorney, and Statewide was sent by Keith's attorney to Statewide, requesting endorsement and return to pay repair expenses. After two weeks without a response, Keith's attorney demanded the return of the insurance check. Statewide failed to return the check, and Keith filed suit. Thereafter, the mortgagee requested a listing of contractors, invoices and contracts for the repair work. During discovery, Keith produced invoices for the repairs for $14,400, and was paid by Statewide. At trial, Statewide contended that it acted reasonably in its request for invoices and contracts to assure that the proceeds were spent on repair. Keith argued that the deed of trust did not require the mortgagor to provide invoices or contracts for the repair and that Statewide made no election on the use of such insurance proceeds before the suit.

The issue addressed was whether a mortgagee can decide, after the mortgagor repaired the property, to apply the insurance proceeds against the loan instead of repair costs. The Court noted that the relative amounts of the insurance proceeds and the balance of the loan were such that Statewide, acting prudently, would have been on notice of the extensive damages to the home, raising a duty on Statewide to make an election within a fairly short period of time. A letter from the mortgagee indicating that repair costs would be paid upon delivery of invoices was

1. Statewide Bank & SN Servicing Corp. v. Keith, 301 S.W.3d 776, 779 (Tex. App.—Beaumont 2009, pet. abated) (quoting deed of trust).

determined to be ambiguous and was insufficient to act as an exercise of the mortgagee's option. A subsequent letter conditioning disbursement of proceeds on a property inspection was further evidence that a formal election had not been unequivocally made. Also, the Texas Insurance Code,[2] which covers the mortgagee's handling of insurance proceeds, requires prompt notice to the homeowner of each requirement for the release of insurance proceeds. A mortgagee has ten days after receipt of the required information in which to release such insurance funds or to specifically explain the reasons for the refusal and the requirements needed for a release.[3]

Since Statewide's first contact was seven weeks after its receipt of the insurance proceeds, and its first payment of repair invoices was seven months after its receipt of the proceeds, this amounted to a failure to timely elect its option. This case is noteworthy for its advice to practitioners. First, the one ambiguous sentence regarding application of insurance proceeds is in stark contrast to typical commercial deed of trust provisions which detail the manner and timing of such election. Clarity and detail are the watchwords. Secondly, this case provides guidance for responses to casualty events. Important factors for reasonable response time include the contractual provisions, the extent of damage, partial funding of insurance proceeds, and applicable statutory provisions.

B. Subrogation

The doctrine of subrogation is addressed in *Chase Home Finance, L.L.C. v. Cal Western Reconveyance Corporation*.[4] Dickerson financed the acquisition of a lot with two notes and deeds of trust: a $300,000 first lien deed of trust (Dickerson I) and a $75,000 second lien deed of trust (Dickerson II). Dickerson sold the property to Gooch without discharging the Dickerson I and Dickerson II deeds of trust. After filing for bankruptcy, Gooch sold the properties to Landin, who financed the purchase through People's Choice Home Loan with two notes and deeds of trust: a $341,600 first lien deed of trust (Landin I) and $85,400 second lien deed of trust (Landin II). The Landin I deed of trust provided for subrogation to all superior liens paid off by proceeds from the Landin I note. The holder of the Dickerson I note and deed of trust received a check in full payment of the Dickerson I note for $348,000 and signed a release of the Dickerson I deed of trust. The Dickerson II note was not paid off. Upon foreclosure of the Landin I deed of trust, the mortgagee, HSBC Bank, acquired the property for $361,000. After this foreclosure, the Dickerson II deed of trust was assigned to Real Time Resolutions (RTR). The Dickerson II deed of trust was posted for foreclosure. Chase Homes filed suit to prevent the foreclosure on the Dickerson II deed of trust. Chase Homes claimed that the Landin I deed of trust was subro-

2. Tex. Ins. Code Ann. § 557.002(a) (West 2009).
3. Tex. Ins. Code Ann. § 557.003 (West 2009).
4. 309 S.W.3d 619 (Tex. App.—Houston [14th Dist.] 2010, no pet.).

gated to the Dickerson I deed of trust; however, RTR claimed that subrogation would be inequitable. The trial court concluded that the Dickerson II deed of trust had priority over the Landin I deed of trust "on the principle that a junior lienholder should not be granted subrogation to the superior or equal equities of others with recorded interests would be prejudiced thereby."[5] The appellate court reviewed a number of cases dealing with the equities of subrogation.

In *Texas Commerce Bank National Assoc. v. Liberty Bank*,[6] a property subject to a first, second and third lien was sold with purchase money financing from Liberty Bank. Liberty Bank's loan was secured by a deed of trust containing subrogation language. The proceeds were used to pay off the balances of the first and second lien notes and deeds of trust, and the holders of the first and second lien deeds of trust released their liens. Shortly after the Liberty Bank loan, Texas Commerce Bank, the holder of the third lien, foreclosed its lien on the property. After default by the new purchaser, Liberty Bank foreclosed on its lien. Texas Commerce Bank alleged prejudice because Liberty Bank had not discharged Texas Commerce Bank's lien. However, the court concluded that "[n]either actual nor constructive knowledge of an intervening lien would defeat the rights of subrogation if the senior lien were discharged under an express agreement," and the release of lien by the prior lienholder, rather than an assignment of lien, would not prejudice Liberty Bank's right of subrogation.[7]

The court also considered the claim that the foreclosure bid price of $361,000 exceeded the $348,000 Dickerson I balance. Since the Texas Finance Code allows a subrogated party to accrue interest at six percent per annum, and the foreclosure bid was less than the principal amount plus interest at the statutory rate, then subrogation for the full amount of the foreclosure bid was valid.[8] RTR further argued that the subrogation, if appropriate, should have been limited only to the original principal amount and not the interest amount. The court concluded that interest at the statutory rate would also have priority over the existing subordinate lien.

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5. *Id.* at 624. The trial court's refusal to enforce subrogation against the Dickerson II note and lien were based on six factors. First, the variable interest rate on the Landin I note would cause over $100,000 in additional interest, representing a material prejudice. Second, the release of the original mortgagor and the replacement and assumption by a subsequent borrower who was not properly qualified as a suitable borrower, as well as high initial fees and high increasing variable rates would be a material prejudice. Third, the subrogated note was $41,000 greater in principal than the original Dickerson I note. Fourth, the financial status of the debtor under the Landin I note increased the likelihood of foreclosure and the additional costs and expenses attendant thereto. Fifth, the subrogation with a higher principal amount effectively converted accrued but unpaid interest into principal, increasing the burden on the property. Finally, a prudent second lienholder would not voluntarily subordinate its position to a loan with the characteristics of the Landin I loan.

6. 540 S.W.2d 554 (Tex. Civ. App.—Houston [14th Dist.] 1976, no writ).

7. *Chase Home*, 309 S.W.3d at 628 (citing Province Inst. for Savings v. Sims, 441 S.W.2d 516, 519 (Tex. 1969)).

8. *Id.* at 629 (citing TEX. FIN. CODE ANN. § 302.002 (Vernon 2006)).

RTR raised a "loss of protection" argument, which the court dismissed.[9] In the *Fleetwood* cases, Fleetwood held a first lien deed of trust and a subordinate leasehold interest in real property. A subsequent lender advancing funds was subrogated to the first lien deed of trust in *Fleetwood I*, based upon a loss of protection theory. However, the Texas Commerce Bank court looked at *Fleetwood II*, and concluded that the Fleetwood loss of protection argument was not a legal or vested right and was abandoned in *Fleetwood II*.[10] Further, no other Texas cases have adopted a loss of protection theory of prejudice in a subrogation analysis.

Next, RTR asserted that subrogation arises from equity and thus requires a trial court to weigh the equities. The court discussed the three types of subrogation: a purely contractual subrogation where there is a contract between all parties to the subrogation dispute; an equitable subrogation where there is no language in any instrument speaking to subrogation; and a hybrid category where there is contractual subrogation language in a document not with the mortgagee disputing the subrogation claim.[11] Even in the hybrid category, where "the analysis does involve equitable considerations, each case is not controlled by its own facts and the subsequent lender can be entitled to subrogation as a matter of law."[12] Therefore, the subrogated lender's actual or constructive knowledge of the existing lien would not defeat subrogation. Consequently, the court concluded that RTR would not be prejudiced by subrogation in favor of Chase Homes.

RTR also challenged Chase Homes' proof of entitlement to subrogation, and the court addressed the necessary proof.[13] The court determined such evidence conclusively proved the proceeds from the Landin I note were used to pay off the Dickerson I note, notwithstanding that the release was executed nearly one year after the closing.[14]

This case should effectively shut the door to future loss of protection claims, even in equitable subrogation cases. Further, this case provides the factual evidence needed to prove the payoff of a prior lien.[15]

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9. *See* Fleetwood v. Med. Ctr. Bank, 786 S.W.2d 550 (Tex. App.—Austin 1990, writ denied) (Fleetwood I); and on appeal a second time in Med. Ctr. Bank v. Fleetwood, 854 S.W.2d 278 (Tex. App.—Austin 1993, writ denied) (Fleetwood II).

10. *Chase Home*, 309 S.W.3d at 630–31.

11. *Id.* at 631.

12. *Id.* at 631 (citing Providence Inst. for Sav. v. Sims, 441 S.W.2d 516 (Tex. 1969).

13. *Id.* at 633. The uncontroverted evidence of the payoff of the prior loan included: a payoff demand prepared by lender's attorney reflecting a loan number related to the prior lien paid off; the closing statement reflected the title company's file number relating to the property acquisition and payoff, and reflected the payoff amounts from the payoff letter; title company checks in the amounts required in the payoff letter, containing the file number of the title company; correspondence transmitting the checks which reference the same loan number as in the payoff letter; negotiation of the payoff checks on or about the date of closing; the title company's letter transmitting a release of lien which referenced the title company file number and the loan number; and an executed release of lien referencing the loan number.

14. *Id.*

15. *See supra* text accompanying note 13.

III. DEBTOR/CREDITOR

A. FRAUDULENT TRANSFER

While there were many more cases in this area this year than in previous years, only two cases are truly noteworthy.

The first case presents a matter of first impression under The Texas Uniform Fraudulent Transfer Act (TUFTA).[16] In *Corpus v. Arriaga*,[17] Modesto and Felicita Arriaga purchased properties from Wessendorff. The Arriagas contracted with Corpus for the construction of a dancehall on one of the properties; however, construction of the dancehall ceased, and Corpus sued the Arriagas. Several months later, the Arriagas filed for bankruptcy, staying the lawsuit. In 2002, the Arriagas sold one of the properties and extinguished the debt and lien on that property. In 2003, the Arriaga's bankruptcy was voluntarily dismissed, and the lawsuit was litigated to a judgment in favor of Corpus. Fifteen days after the final judgment in the lawsuit, the Arriagas transferred the remaining properties to their children Pete and Delao Arriaga. Corpus claims that the property transferred to Pete and Delao was fraudulent under TUFTA.

At trial, evidence was introduced that the senior Arriagas had entered into an oral agreement at the time the properties were purchased and that the properties belonged jointly to the Arriagas and their two children Pete and Delao. Testimony reflected that Pete and Delao had made monthly payments on the Wessendorff note from 1994 through 2002, when the note was paid off. The trial court found that an agreement existed among the family members which was entered into before any judgment or claim that Corpus could have made in the case. Corpus countered that an oral agreement between the Arriaga family members did not constitute a transfer and that the actual transfer occurred when the deeds were recorded. On appeal, the court reviewed TUFTA Section 24.007.[18] The court found that no Texas court had interpreted this section, but relied on other jurisdictions' holdings that a transfer is made when a deed is recorded and concluded that Texas law would support a similar interpretation.[19] In support, the court held that TUFTA was similar to Texas recording statutes,[20] requiring that a deed be recorded to cut off rights of a subsequent purchaser for value without notice. Therefore, the court held that the verbal agreement between the Arriaga family members was not a transfer, but that, for purposes of TUFTA, the transfer occurred when the deed was recorded.[21]

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16. TEX. BUS. & COM. CODE ANN. § 24.001-.013 (West 2009) [hereinafter TUFTA].

17. Corpus v. Arriaga, 294 S.W.3d 629 (Tex. App.—Houston [1st Dist.] 2009, no pet.).

18. *Id.* at 634–35 (citing TEX. BUS. & COM. CODE ANN. § 24.007(1)(A) (West 2002) ("[A] transfer is made . . . with respect to . . . real property . . . when the transfer is so far perfected that a good faith purchaser of the asset from the debtor against whom applicable law permits the transfer to be perfected cannot acquire an interest in the asset that is superior to the interest of the transferee")).

19. *Id.* at 635.

20. *Id.* (citing TEX. PROP. CODE ANN. § 13.001 (West 1984)).

21. *Id.* at 636.

The court also considered whether reasonably equivalent value was exchanged at the time of the transfer.[22] Delao contributed a total of $8,580 toward the mortgage debt, but the property had an appraised value of $16,060 when it was transferred. Pete paid the mortgage, property improvements and property taxes totaling $37,000, compared to the $109,000 appraisal value for his property. Therefore, the court concluded Pete and Delao did not give reasonably equivalent value for the property at the time of its transfer.

The decision as to equivalent value seems questionable. Apparently there was no evidence concerning the time value of money, and the appellate court did not discuss that concept. Nevertheless, this author believes that holding a current period value as being equivalent to a series of payments over an eight year period starting fourteen years prior overlooks a fundamental aspect of financial investment analysis.

B. Absolute Assignment of Rents

The most important case during this review period deals with the absolute or collateral assignment of rents, which has been the subject of numerous cases and commentaries over the last twenty years. *In re Amaravathi Limited Partnership*[23] is a bankruptcy case in which Amaravathi owned four upscale apartment properties. The properties were insured and in excellent physical condition with stable occupancy and generated a positive cash flow before debt service. The issue was whether the rents from such properties were assets of the bankruptcy estate; the court concluded that they were.[24] These properties were financed and secured by a note, deed of trust, assignment of rents, and a cash management agreement, all of which were securitized and placed into a securitization pool. Pursuant to the loan documentation, Amaravathi collected the rent and deposited it into a lockbox under the cash management agreement. The servicer deducted the debt service from the lockbox deposits and funded the remainder to the debtor. When the net cash flow was insufficient for proper maintenance and operation of the property and payment of debt service, Amaravathi stopped depositing rents into the lockbox, in breach of the loan documents. A receiver was obtained, but Amaravathi filed a Chapter 11 bankruptcy petition. Amaravathi, in a cash collateral motion, requested use of the rents; the creditor opposed, alleging that the assignment of rents was absolute under Texas law and that the debtor had no further interest in the rents. The issue considered by the court was whether the rents were cash collateral that could be used under § 363 of the Bankruptcy Code.[25] Property rights in post-petition rents are determined by applicable state

22. *Id.*, (citing Mladenka v. Mladenka, 130 S.W.3d 397, 407 (Tex. App.—Houston [14th Dist.] 2004, no pet.)).

23. *In re* Amaravathi Ltd. P'ship, 416 B.R. 618 (S.D. Tex., Houston Div. 2009).

24. *Id.* at 622.

25. *Id.* at 624 (citing 11 U.S.C. § 363 (2006)).

law under *Butner v. United States*;[26] however, the Supreme Court in *Butner* determined that federal bankruptcy law would override state law, if Congress enacted a statute defining the rights to post-petition rents.[27] The court in *Amaravathi* concluded that neither the Fifth Circuit nor the Supreme Court had directly addressed the Bankruptcy Code's treatment of post-petition rents, that Bankruptcy Code § 541(a)(6)[28] was unambiguous, and that rents from these apartments came from property of the estate and that such rents were property of the estate.[29]

The creditor presented two cases which the court distinguished. In *Jason Realty, L.P. v. First Fidelity Bank, N.A.*,[30] a case decided under New Jersey law, the court determined that Texas law was different than New Jersey law regarding title under absolute assignments of rents. Furthermore, the *Jason Realty* case did not address Bankruptcy Code § 541(a)(6). The other case, *Sovereign Bank v. Schwab*,[31] did not address the effect of Bankruptcy Code § 541(a)(6) upon post-petition rents, even though it determined that post-petition rents were property of the bankruptcy estate. In contrast to these Third Circuit cases, the court noted Second and Seventh Circuit decisions supporting post-petition rents being property of the bankruptcy estate.[32] Each of these cases specifically addressed Bankruptcy Code § 541(a)(6) and found that the rent from the property was the property of the bankruptcy estate.

The remaining question was whether legal and equitable interest in future rents were held by the debtors or the creditor, which must be decided under Texas law. The two leading cases for assignment of rents in Texas are *Taylor v. Brennan*[33] and *In re International Properties, Ltd.*[34] In *Taylor*, an apartment owner used rents that were collected after a default. In that decision, the Texas Supreme Court held that in a collateral assignment of rents, the lender must take some affirmative action to activate its rights to the rents, including obtaining possession of the property, impounding the rents, securing the appointment of a receiver, or other similar action.[35] In explaining the difference between a collateral and absolute assignment of rents, the Texas Supreme Court noted that, "an absolute assignment operates to transfer the rights to rentals automatically upon the happening of a specified condition, such as default."[36] In *Inter-*

26. Butner v. United States, 440 U.S. 48 (1979).

27. *Id.* at 54.

28. Amaravathi, 416 B.R. at 623. This provision reads, in relevant part, as follows: "Such estate is comprised of all of the following property. . ." (6) proceeds, product, offspring, rents, or profits of or from property of the estate. . ." 11 U.S.C. § 541(a)(6)(2006).

29. *Amaravathi*, 416 B.R. at 623.

30. *See* Jason Realty, L.P. v. First Fid. Bank, N.A., 59 F.3d 423 (3d Cir. 1995).

31. *See* Sovereign Bank v. Schwab, 414 F.3d 450 (3d Cir. 2005).

32. *See In re* Vienna Park Props., 976 F.2d 106, 111, 114 (2d Cir. 1992); *In re* Wheaton Oaks Office Partners Ltd. P'ship, 27 F.3d 1234, 1240 (7th Cir. 1994).

33. *See generally* Taylor v. Brennan, 621 S.W.2d 592 (Tex. 1981).

34. *See generally In re* Int'l Props. Ltd., 929 F.2d 1033 (5th Cir. 1991).

35. 621 S.W.2d at 595.

36. *Id.* at 594 (citing Kinnison v. Guar. Liquidating Corp., 115 P.2d 450, 453 (Cal. 1941)).

national Properties, the court addressed whether the assignment of rents was absolute or collateral and determined that the mortgage documents demonstrated an intent to create an absolute assignment. Based on that conclusion, the *International Properties* court determined "that the mortgagee should have the right to rents immediately upon default."[37] The *International Properties* court determined that the absolute assignment terminology is essentially a legal fiction, since both collateral and absolute assignment of rents are employed to secure a debt.[38] Therefore, the *Amaravathi* court concluded that "*Taylor's* statement . . . that an 'absolute' assignment of rent passes title to the rents to the lender" was dicta and was both not binding and not accurate.[39] In other words, *Taylor* did not elaborate on whether legal title, equitable title, or both passed to the lender in connection with an absolute assignment of rents. *International Properties* determined that an absolute assignment of rents was a transfer of legal title to rents, but not an equitable right, until the occurrence of specified conditions.[40] Both *Taylor* and *International Properties*, although decided under Texas law, were decided outside the context of an existing bankruptcy case. However, the issue before the *Amaravathi* court involved an existing bankruptcy case and application of Bankruptcy Code § 541(a)(6). Because neither *Taylor* nor *International Properties* were decided under bankruptcy law, this court looked to *United States v. Whiting Pools, Inc.*[41]

In this case, the IRS seized property to satisfy a tax lien, but Whiting Pools filed Chapter 11 the next day; whereupon, the IRS sought relief from the bankruptcy automatic stay, and Whiting counterclaimed for a turnover order. The United States Supreme Court held that the reorganization estate included the property of the debtor that had been seized by a creditor prior to the filing of a petition for reorganization, finding that Bankruptcy Code § 542(a) is one of several provisions which brings into the estate "property in which the debtor did not have a possessory interest at the time the bankruptcy proceeding commenced."[42] The Supreme Court clarified this to mean that if a tax levy or seizure operates to transfer ownership of the property seized, then Bankruptcy Code § 542(a) may not apply. Ownership of seized property is transferred to a bona fide purchaser only at a tax sale; until then the title to the property remains with the debtor.[43] Therefore, the *Amaravathi* court concluded that the post-petition rents at issue were the property of the bankruptcy estate, with the key difference between this case and *International Properties* being the bankruptcy context. The *Amaravathi* court specifically stated that outside of bankruptcy, a lender with an absolute assignment of rents

37. 929 F.2d at 1038.
38. *Id.* at 1035.
39. *In re* Amaravathi Ltd. P'ship, 416 B.R. 618, 631.
40. 929 F.2d at 1036.
41. *See generally* United States v. Whiting Pools, Inc., 462 U.S. 198 (1983).
42. *Id.* at 205.
43. *Id.* at 211.

would, upon the happening of the specified event or condition, be immediately vested with rights to the absolutely assigned rents. Since Amaravathi held an equitable interest in the rents at the time of the bankruptcy filing, such equitable title to future rents would be part of the bankruptcy estate despite the absolute assignment of rents in favor of the creditor.[44]

This case should have a profound effect on issues of assignment of rents litigated in the bankruptcy context, since it is irrelevant how artful an assignment of rents provision is drafted to be absolute rather than collateral. Nevertheless, this case does not mitigate against proper drafting for absolute assignment of rents outside the bankruptcy context.

Although subsequent to the survey period, the Texas Legislature enacted the Texas Assignment of Rents Act (TARA).[45] TARA, which became effective June 17, 2011 for deeds of trust and similar security instruments executed thereafter, provides a statutory framework for the creation, perfection and enforcement of assignment of rents which will override existing case law regardless of whether documented or classified as collateral assignment or absolute assignment. A complete analysis of TARA is beyond the scope of this article, but the following paragraphs provide a summary of the salient provisions of TARA.

TARA applies broadly to any security instrument containing an assignment of rents or a security interest or lien in commercial real property, and defines rents as the consideration payable in exchange for the right of possession or occupancy of real property.[46] The recording of such security instrument constitutes perfection of the security interest in rents.[47] After a default under the security instrument, enforcement of the assignment of rents is accomplished by either notice to the assignor, notice to the tenants of the property or by other means sufficient under Texas law to enforce such assignment.[48] A statutory form of notice is specified in TARA, which should be used to initiate the enforcement of the assignment of rents.[49] Priority of assignments of rents typically follows existing

44. 416 B.R. at 634–36. The court discussed at some length why absolute assignment of rents do not grant full title to the mortgagee, and that the debtor retains an equitable title and interest in the rents. The four factors included: (1) the right of the debtor to require application of rents to the debt or operating expenses of the property, or a right of accounting, and the contractual limitation on the creditor's rights to use of the rents; (2) the right of the borrower to use rents in excess of operating expenses and debt service; (3) the connection between the absolute assignment of rents and a related mortgage debt, which indicates there was not a true sale of rents (the court determined that the lockbox arrangement did not constitute a transfer of ownership or a true assignment of the rents) and that the risk of non-payment of rents resided with the debtor not the lender; and (4) that the absolute assignment of rents terminated upon payment of the debt.

45. TEX. S. B. 889, 82nd Leg. (2011) (to be codified at TEX. PROP. COD, Ch. 64). TARA was modeled on the Uniform Assignment of Rents Act with necessary changes for Texas Law. UNIF. ASSIGNMENT OF RENTS ACT (2005), *available at* http://www.law.upenn.edu/bll/ulc/maripp/2005Final.pdf.

46. TEX. PROP. CODE ANN. § 64.001 (West 2011).

47. TEX. PROP. CODE ANN. § 64.052 (West 2011).

48. TEX. PROP. CODE ANN. § 64.053 (West 2011).

49. TEX. PROP. CODE ANN. § 64.056 (West 2011).

law relating to lien priorities. Significantly, TARA provides that such enforcement does not make the assignee a mortgagee in possession or agent of the assignor, does not constitute an election of remedies or make the secured obligations unenforceable, limit other available rights of the assignee, or bar a deficiency judgment,[50] each of which were unclear under existing common law. TARA also addresses the application of the rents collected.[51]

TARA will require immediate action in revising commercial property documents such as deeds of trust, lease agreements and subordination, non-disturbance and attornment agreements. Practitioners representing mortgage lenders, mortgage borrowers and tenants will need to make those adjustments in light of the new statutory framework for the creation, perfection and enforcement of assignments of rents.

IV. GUARANTIES/INDEMNITIES

In current commercial mortgage lending practice, most guaranties, and almost all guaranties in the securitization context, contain limited guaranties with recourse liability only for what are commonly known as "bad boy carve-outs." These carve-out provisions are discussed in *Fath v. CSFB 1999—C1 Rockhaven Place L.P.*[52] In connection with the financing of various apartment complexes, Fath executed a guarantee which provided recourse liability for fraud and gross negligence amounting to physical waste of the property. The subject properties were Forest Cove I, Forest Cove II and Forest Cove III, and the facts relate to the condition and affairs relating to Forest Cove III. Fath spent $1,600,000 on exterior and interior renovations. As market conditions deteriorated, Fath slowed down and then stopped the renovations at Forest Cove III. Monthly mortgage payments were later stopped and the loan was declared in default. At foreclosure sale, Rockhaven bid $1,650,000 and later sued Fath for breach of the guaranty. Fath appealed the judgment in favor of Rockhaven.

A. Fraud Recourse Carve-Out

Rockhaven had asserted that Fath committed fraud by not completing and paying for the renovations for Forest Cove III, thereby triggering the recourse liability. Fraud occurs only when a promise to do an act in the future is made with no intention of performing the promise at the time the promise was made. Fath intended to complete the renovations at the time the loan was obtained. Testimony proved the 2004 budget did not include interior renovation funds because of the deteriorating market conditions. Furthermore, Fath had made mortgage payments for over three years, had followed a plan of renovation for Forest Cove I, Forest

50. Tex. Prop. Code Ann. § 64.057 (West 2011).
51. Tex. Prop. Code Ann. § 64.058 (West 2011).
52. *See generally* Fath v. CSFB 1999-Cl Rockhaven Place Ltd. P'ship., 303 S.W. 3d 1 (Tex. App.—Dallas 2009, pet denied).

Cove II and Forest Cove III in that order, and had spent over of $4,000,000 on mortgage payments and renovations. Also, the loan documents did not contain a deadline for renovations. All of these facts led the court to conclude that there was insufficient evidence to show fraud at the time the property was acquired and loan obtained.

B. WASTE RECOURSE CARVE-OUT

Waste. Next the court addressed whether gross negligence or willful misconduct led to physical waste. Evidence supported the claims of gross negligence.[53] Several witnesses had testified that Fath's approach to the renovation (basically the removal of all tenants and the renovation of the property at one time, rather than renovating each building in a sequential manner) deviated from industry standards because it eliminated all cash flow from the property. These witnesses included a contractor, a real estate appraiser, and an employee of the creditor. Fath's contention that renovation of the entirety was necessary due to crime was not viewed as compelling. Having satisfied the gross negligence element, the court looked to the physical waste element.[54] The loan documents allowed renovation of the complex, but did not permit demolition of the interior of the project in preparation of renovations and then abandonment of such work. At the time of the default, many of the apartment units were nothing more than a shell, and evidence reflected that it would cost more than $3,000,000 to repair the damage caused by such renovation efforts. Consequently, the court concluded there was sufficient evidence to support a claim of physical waste.

This case should be helpful to practitioners since most recent guaranties contain non-recourse carve-outs, which typically cover fraud and waste, as well as a host of other sins. It may also be instructional in preparing documents for a renovation loan.

V. PURCHASER/SELLER

A. RIGHT OF FIRST REFUSAL

Two cases deal with rights of first refusal. *FWT, Inc. v. Haskin Wallace Mason Property Management, L.L.P.*,[55] addresses whether the holder of a preferential right can be required to purchase assets that are bundled with the property subject to the preferential right. Haskin Wallace formed Texas Galvanizing, operating a hot dip galvanizing plant. FWT sold Haskin Wallace six acres of undeveloped property located adjacent

53. The elements for gross negligence are: (1) "viewed objectively from the actors standpoint, the act or admission complained of must depart from the ordinary standard of care to such an extent that it creates an extreme degree of risk of harming others;" and (2) "the actor must have actual, subjective awareness of the risk involved and chose to proceed in conscious indifference to the rights, safety or welfare of others." *Id.* at 6.

54. A claim of waste "must show an injury to the reversionary interest in land caused by the wrongful act of a tenant or other party rightfully in possession." *Id.* at 7.

55. 301 S.W.3d 787 (Tex. App.—Ft. Worth 2009, pet. denied).

to FWT's plant. The deed contained a right of first refusal, providing "Grantor shall. . . elect to purchase, lease or otherwise accept such conveyance . . . at the same price and under the same terms and conditions offered by the prospective purchaser." Haskin Wallace then created U.S. Galvanizing to operate a galvanizing business on the property subject to the preferential right and commenced operations. Eventually, Haskin Wallace decided to sell both Texas Galvanizing and U.S. Galvanizing. FWT made an offer to purchase both businesses for $15,500,000, but Haskin Wallace contracted with Valmont Industries to sell both galvanizing businesses for $16,500,000, to lease the subject property for $25,000 per month for five years with two five year extensions, with an option to purchase the property for $2,500,000, and to sublease from Haskin Wallace the property on which Texas Galvanizing was located. In response, FWT sent a letter electing to exercise its right of first refusal as to the subject property only, without agreeing to the other terms in the agreement between Valmont and Haskin Wallace. Haskin Wallace advised FWT that FWT must accept all of the terms of the offer from Valmont, or the offer under the right of first refusal would be considered rejected. Ultimately, Haskin Wallace sued FWT for a declaratory judgment that the right of first refusal had been extinguished. FWT responded that the right of first refusal pertained only to the subject property and that FWT could lease the subject property and have the purchase option for the property. The court concluded that the terms of the option created by the right of first refusal are formed by the provisions of preferential right and the terms and conditions of the third party offer.[56]

The court addressed and distinguished each of the five Texas cases relied upon by FWT. In *Hinds v. Madison*,[57] there was no evidence that the lessor would sell the lesser-included tract alone without selling the whole. The court determined that the preferential right cannot be enlarged to cover other lands owned by the lessor; the right covers nothing except the property actually subject to the option. This holding supported FWT's position that the holder of a preferential right cannot be compelled to purchase assets beyond the scope of the preferential right in order to exercise that right.[58]

In *Riley v. Campeau Homes (Tex.), Inc.*,[59] the court held that the pref-

56. *Id.* at 793 (citing Abraham Inv. Co. v. Payne Ranch, Inc., 968 S.W.2d 518 (Tex. App.—Amarillo 1998, pet. denied)).

57. *See generally* Hinds v. Madison, 424 S.W.2d 61 (Tex. App.—San Antonio 1967, writ ref'd n.r.e.). Madison owned a 14,000 acre tract, of which 2,800 acres was leased to Hinds pursuant to a lease containing a right to sell the property and a right of first refusal on the leased premises. Mason entered into a contract with a third party for the sale of the entire 14,000 acre tract, although such sale was never consummated. Hinds sued to exercise the preferential right, contending it covered the entire 14,000 acre tract for the same price and terms in the contract between Madison and the third party.

58. *FWT*, 301 S.W.3d at 795.

59. *See generally* Riley v. Campeau Homes (Tex.), Inc., 808 S.W.2d 184 (Tex. App.—Houston [14th Dist.] 1991, writ dism'd by agr.). Riley held a lease on a condominium unit containing a preferential right to purchase the property if the landlord received an offer to purchase the leased premises in whole or in part. The condominium owner, Campeau,

erential right was triggered even though the unit was included as part of a package for the entire condominium project. The *Riley* holding was based on the right of first refusal being triggered. The *FWT* court distinguished *Riley*, since the question of triggering the right was not at issue.[60]

In *Comeaux v. Suderman*,[61] the court found that Comeaux received notice and was given an opportunity to exercise the right of first refusal. FWT had relied on a footnote in the *Comeaux* opinion, citing *Riley*, stating that the interest of a preemptive right holder cannot be defeated by selling the subject matter of that right as part of a larger transaction.[62] However, the *FWT* court distinguished *Comeaux*, which it characterized as dealing with the issue of whether the preferential right was triggered.

In *McMillan v. Dooley*,[63] the court discussed *Hinds* and agreed with its reasoning, noting: "if a right holder is not permitted to expand his preferential purchase right to include property not covered by the provision, it would be improper for him to be required to accept other property not covered by his preferential right in order to exercise his right."[64] Nevertheless, the *FWT* court distinguishes *McMillan* by characterizing the package deal as consisting of three unrelated leases, whereas the business assets and properties presented in *FWT* are significantly related.[65] The court also distinguished *McMillan* because there were other preferential right holders relating to properties included in the package, whereas in

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entered into a contract to sell all of the project, including the subject condominium unit. Riley provided notice to exercise the preferential right, and Campeau countered that it had no intention to sell individual units other than in connection with a transfer of the entire project.

60. *FWI*, 301 S.W.3d at 796.

61. *See generally* Comeaux v. Sulderman, 93 S.W.3d 215 (Tex. App.—Houston [14th Dist.] 2002, no pet.). This case involved a one acre tract leased by Comeaux from Suderman. The lease had a preferential right providing that if Suderman received a purchase offer, then Comeaux had a preferential right to purchase the property on the same terms and conditions as those offered by the prospective purchaser. Suderman notified Comeaux of a pending $350,000 cash offer for the subject leased premises as well as "some adjoining property," without specifying the total acreage of the adjoining property to be 35 acres. Comeaux assumed the adjoining property was only 22 acres. Comeaux declined the offer and continued to make lease payments to the new owner. When a storm destroyed his fishing pier, Comeaux abandoned the leased premises, but later sued Suderman and the purchaser under the preferential right. Comeaux argued that his preferential right was never triggered because the notice failed to offer him the right to purchase only the leased premises instead of the group of properties, and that the offer did not contain relevant terms and conditions of the sale.

62. 301 S.W.3d at 797.

63. *See generally* McMillan v. Dooley, 144 S.W.3d 159 (Tex. App.—Eastland 2004, pet. denied). McDonald acquired by assignment three leases containing a preferential right. McMillan expressed an interest in purchasing one of the three leases, and McDonald stated he was interested only in selling the three leases as a package. Thereafter, McDonald conveyed all three leases to McMillan without advising the preferential right holders of the offer. One preferential right holder, Dooley, informed McMillan of the preferential right to the subject lease, and McMillan offered to sell all of the leases, not just the one lease, to Dooley. Dooley declined, and together with the other preferential right holders, sued McMillan.

64. *Id.* at 799.

65. 301 S.W.3d at 798.

FWT, there were no other competing right holders.[66] To this author, this seems to be faulty logic. As to the distinguishing characteristic of similarity of properties, in *McMillan* all three properties were oil and gas lease properties, which is exactly the type of property in which Dooley held a preferential right. But in *FWT*, the asset package included operating businesses. Therefore, the right was converted from covering a property to covering an operating business. It is illogical to suggest that the inclusion of operating businesses in the offer package is a similar type property.

In *Navasota Resources, L.P. v. First Source Texas, Inc.*,[67] the court, citing *Hinds*, *McMillan* and *Comeaux* approvingly, stated that "virtually every authority of which we are aware agrees that the holder of a preferential right cannot be compelled to purchase assets beyond those included in the scope of the agreement subject to the preferential right in order to exercise that right."[68] The *Navasota* court concluded that Navasota could purchase the interest in the Hilltop Prospect without complying with the other terms of the Chesapeake arrangement. But the *FWT* court distinguished *Navasota* because the additional properties were unrelated to the property subject to the preferential right.[69] This newly envisioned factor of "relatedness" seems very appropriate to this author, but how the *FWT* court can justify it with the "similarity" holding in *McMillan* is baffling.

Haskin Wallace relied on the authority of *West Texas Transmission, L.P. v. Enron Corp.*,[70] where the court determined that the grantor of a right of first refusal controls the conditions of the right, provided those conditions are commercially reasonable, imposed in good faith, are not designed to defeat the preemptive right, and the right holder cannot then

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66. *Id.*

67. *See generally* Navasota Res., L.P. v. First Tex., Inc., 249 S.W.3d 526 (Tex. App.—Waco 2008, pet. denied). Navasota and First Source owned a respective 55 and 45 percent working interest in the Hilltop Prospect. Their joint operating agreement contained a preferential right in the event any party desired to sell any or all of its interest. The parent company of First Source, Gastar, signed a letter of intent whereby Chesapeake would (i) purchase 19.9% of Gastar's stock, (ii) purchase 33.33% of First Source's working interest in the Hilltop Prospect, and (iii) enter into an area of mutual interest comprising 13 counties in East Texas. First Source notified Navasota of the Chesapeake deal and stated it would be obligated to pay Gastar for the one-third of its leasehold acreage in the Hilltop Prospect and a percentage of drilling costs, but without requiring Navasota to purchase Gastar's stock or enter into the multi-county area's interest agreement. Navasota elected to exercise its preferential right, but First Source sent a second notice requiring Navasota to comply with every aspect of the Chesapeake deal. Navasota refused to accept that offer and Gastar and Chesapeake consummated their agreement.

68. *Id.* at 535.

69. 301 S.W.3d at 799.

70. W. Tex. Transmission, L.P. v. Enron Corp., 907 F.2d 1554, 1557–58 (5th Cir. 1990). Valero held a preferential right to purchase an interest in a pipeline if Enron decided to sale its interest. The preferential right provided it was to be on the same terms and conditions set forth in the third party offer. Enron and TECO Pipeline Company negotiated a deal to sell Enron's interest in such pipeline and all of Enron's stock in Nortex. The agreement was expressly conditioned on the FTC's approval of the sale. Valero chose to exercise its preferential right, but declined to agree to the FTC approval condition. When the FTC disapproved the sale to Valero, this suit followed.

remove the specific conditions from the contract or extract other concessions.[71] The *FWT* court admits that *West Texas Transmission* involved only a single asset, instead of multiple assets as in *FWT*, but nevertheless finds it applicable because the preferential right holder had to accept the additional condition of FTC approval; the additional condition in *FWT* was acquisition of the other business assets.[72] The *FWT* court's characterization of a contractual condition being the equivalent of the addition of operating businesses in the offer package appears disingenuous to this author. The result in *West Texas Transmission* was that the right holder could elect to exercise its option on only the property subject to the right if the condition in the contract was satisfied.[73] In *FWT*, the result would require the right holder to purchase not only the property subject to the right but additional properties and various businesses.[74] This is neither logical nor fair.

The *FWT* court analyzed *Texas State Optical, Inc. v. Wiggins*,[75] which held that the general rule on preferential rights is that the acceptance must be unequivocal and a purported acceptance containing a new demand is deemed a rejection; however, a condition of a preferential right could be disputed if it was commercially unreasonable, was included in bad faith, or was intended to defeat the right of first refusal.[76] Again, it is unclear to this author how a legitimate challenge to nefarious conditions justifies the *FWT* decision.

Finally, the court discussed *Shell v. Austin Rehearsal Complex, Inc.*,[77] concluding that *West Texas Transmission* and *Texas State Optical* followed Texas law, which has "long recognized that the failure of the optionee to strictly comply with the terms and conditions of the option contract may be excused when the failure is caused by the conduct of the

71. *FWT*, 301 S.W.3d. at 800.

72. *Id.*

73. *West Texas Transmission*, 907 F.2d at 1562–63.

74. *FWT*, 301 S.W.2d at 789–90.

75. Tex. State Optical, Inc. v. Wiggins, 882 S.W.2d 8, 9–10 (Tex. App.—Houston [1st Dist.] 1994, no writ). Dr. Kernek purchased a retail store and professional optometry practice from Texas State Optical (TSO). TSO retained a preferential right to purchase Dr. Kernek's business if he received an offer to purchase the business. After Dr. Kernek's death, his wife entered into an agreement with Wiggins to sell the business. TSO exercised its preferential right, but reserved the right to dispute clauses in the agreement between Kernek and Wiggins as to commercial reasonability, good faith, and intent to defeat a preferential right. The disputed clauses gave Wiggins a buyer's commission and a one year employment contract to certain employees.

76. *FWT*, 301 S.W.3d at 800.

77. Shell v. Austin Rehearsal Complex, Inc., No. 0397-00411-CB, 1998 WL 476728, at *1–2 (Tex. App.—Austin Aug. 13, 1998, no pet.) (not designated for publication). Austin Rehearsal leased space in a building owned by Shell. The lease contained a preferential right upon an offer to lease other space in the same building and gave Austin Rehearsal the right to lease such other property. A notice of a new space lease was sent to Austin Rehearsal. Shell refused to lease the space after Austin Rehearsal exercised its preferential right. Shell contended that Austin Rehearsal did not effectively exercise its option because its acceptance was conditional, reserving the right to have a court determine the legality of the permitted use and other terms and conditions of the offer.

optionor."[78] In another leap of logic, the *FWT* court concluded that the exceptions stated in *Texas State Optical* were applicable in *FWT*.[79]

The *FWT* court concluded that the general rule in Texas is that "the holder of a preferential right cannot be compelled to purchase assets beyond the scope of the agreement subject to the preferential right in order to exercise that right," but an exception to the rule exists when the "preferential right is expressly made subject to the same terms and conditions offered by a prospective, bona-fide third party purchaser."[80] In cases where the terms and conditions of the offer are incorporated in the preferential right, the issue turns on whether the conditions are commercially reasonably, imposed in good faith, and not designed to defeat the preferential right.[81] These exceptions have only been applied to single asset scenarios, but the *FWT* court concluded that there is no reason the exception should not apply in the multiple assets scenarios.[82] The court provided no analysis for such conclusion. Since the preferential right provision in *FWT* clearly required the exercise of the preferential right to be on the same terms and conditions offered by the purchaser, *FWT* would be required to purchase all of the multiple assets absent one of the defeating conditions.[83] The court concluded no such conditions existed and held that *FWT* was required to acquire the multiple assets contained in the proposal.[84]

This case can and should be questioned for its analysis and effect, and should not be relied upon for precedential value. In avoiding the Texas rule that a preferential right holder cannot be compelled to purchase assets beyond the scope of the preferential right in order to exercise that right,[85] the court went to great lengths and used faulty logic to craft new exception principles to the general rule.[86] These problems are presented in the context of a preferential right property which is sold as part of a larger group of properties. The *FWT* court ignores precedential value of various cases, characterizing them as fundamentally different because they deal only with the "triggering" aspect of the preferential right.[87] Triggering type cases are those where the preferential right is exercisable because the subject property is either less than all of the preferential right property or the preferential right property is included as part of a larger group of properties.[88] How are these cases different from *FWT*? The

78. *FWT*, 301 S.W.3d at 801.
79. *Id.*
80. *Id.*
81. *Id.* at 801–02.
82. *Id.* at 802.
83. *Id.*
84. *Id.* at 803.
85. *Id.* Navasota Resources, L.P. v. First Source Tex., Inc., 249 S.W.3d 526, 535 (Tex. App.—Waco 2008, pet. denied).
86. *FWT*, 301 .W.3d at 801.
87. *See id.* at 796–97.
88. *See* Comeaux v. Suderman, 93 S.W.3d 215, 219 (Tex. App.—Houston [14th Dist.] 2002, no pet.); Riley v. Campeau Homes, Inc., 808 S.W.2d 184,187 (Tex. App.—Houston [14th Dist.] 1991, writ dism'd by agr.).

McMillan case hits the nail on the head, indicating that a right holder who cannot expand his preferential right to additional properties should not be required to accept additional properties in order to exercise his preferential right.[89]

The *FWT* court fails to address numerous practical considerations. If a larger group of property is to be sold, the property owner has knowledge of the existing preferential right to the lesser included tract and should be charged with addressing that right in the offer. The offer could be structured in numerous ways: the preferential right property could be excluded upon exercise of the right; the preferential right property could be subject to a separate contract of sale; or the purchase price could be altered based upon the exercise or non-exercise of the preferential right. The property owner is in a better position to deal with a subsequent purchaser, having granted away the preferential right; the preferential right holder is disadvantaged if he must acquire more properties than were included in the preferential right.

This decision should provide practitioners significant guidance on how to draft preferential rights in order to avoid unintended results. These might include the inclusion of a covenant not to include more property in the offer, or a provision that all of the property covered by the preferential right must be the subject of an offer, such that portions of the preferential right property cannot be sold without the whole.[90] Perhaps, preferential right covenants can provide for separate pricing of the preferential tract if it is part of a larger or lesser tract of land. Finally, a covenant not to include operating businesses, as distinguished from either undeveloped land or land subject to specified types of development should be included. This last suggestion raises the most outrageous reasoning of the *FWT* court: the characterization of what constitutes similar or related properties justifying the inclusion of additional properties as a requirement for the exercise of a preferential right. In this case, the *FWT* court concluded that the preferential right property (undeveloped land at the time of the grant) could be tied with the sale of the ongoing business of a galvanizing plant, since they were related.[91] On the other hand, the court concluded that three oil and gas leases were of a different nature and character to avoid tying the larger group of properties with the preferential right property.[92] This does not seem rational or logical, and the court did not attempt to explain its reasoning. On the whole, this author believes that future courts will take a different position and provide more sound reasoning in this area; until then, practitioners should be wary.

The second right of first refusal case reviewed is *Hicks v. Castille*.[93] Castille purchased from Hicks 96 acres of a 100 acre tract.[94] The remain-

89. McMillan v. Dooley, 144 S.W.3d 159, 179 (Tex. App.—Eastland 2004, pet. denied).
90. *But see* Hicks v. Castille, *infra* at note 70 and accompanying text.
91. *FWT*, 301 S.W.3d at 802–03.
92. *McMillan*, 144 S.W.3d at 179.
93. Hicks v. Castille, 313 S.W.3d 874 (Tex. App.—Amarillo 2010, pet. denied).
94. *Id.* at 878.

ing four acres included a .28 acre tract subject to a tower lease with American Tower. Castille held a right of first refusal to purchase both the four acre tract and the American Tower lease.[95] Hicks ultimately sent a notice to Castille of the intent to sell the .28 acre tract.[96] Castille did not exercise the option and filed for declaratory judgment, asserting the preferential right required Hicks to sell the four acre tract as a whole.[97] In construing this provision, the court looked at the rights and restrictions of a holder of a right of first refusal.[98] Of particular importance is whether the holder of a right of first refusal can compel a sale to prevent a sale or to compel an unwilling owner to convey the property.[99] The court looked at the doctrine of restraint against alienation, which is "an inherent and inseparable quality of an estate in fee simple."[100] A restrain on alienation is "an attempt by an otherwise effective conveyance or contract to cause a later conveyance . . . to terminate or subject to termination all or part of the property interest conveyed."[101] The court concluded that Castille's construction of the right of first refusal would be the equivalent of an unreasonable restraint on alienation since there would be a prohibition on selling any portion of the land in question, other than the entire four acres, for an indeterminable period of time.[102] Note that *Hicks* distinguishes *FWT* on the basis that in *FWT* the contemplated sales terms went beyond the scope of the right of first refusal, whereas in *Hicks* the .28 acres was part of the four acres on which the right of first refusal existed.[103]

The unlimited duration factor was important to *Hicks* ruling. The court cites *O'Conner v. Thetford*[104] for the proposition that restrictions on transfer may be valid if they are of reasonable duration. The court, in an utilitarian perspective, considered the purposes and restrictions associated with the right of first refusal and construed the agreement in a way so as not to invalidate the right of first refusal.[105] The ruling illustrates the dilemma in such an all-or-nothing construction: "either it disallows Hicks to sell a portion of his property infringing on his ownership . . . or it compels him to sell more [land] than he desire to sell."[106] Consequently, Castille's right of first refusal was triggered upon notice of the sale of the .28 acres, and having remained unexercised, the right of first refusal

95. *Id.*
96. *Id.*
97. *Id.*
98. *Id.* at 880–81.
99. *Id.* at 881.
100. *Id.* at 881–82 (citing Potter v. Couch).
101. Navasota Res., L.P. v. First Source Tex., Inc., 249 S.W.3d 526, 537–38 (Tex. App.—Waco 2008, pet. denied).
102. *Id.* at 882.
103. 313 S.W.3d at 882, fn. 5.
104. O'Conner v. Thetford, 174 S.W. 680, 681 (Tex. Civ. App.—San Antonio 1915, writ ref'd).
105. *Hicks*, 313 S.W.3d at 883.
106. *Id.* at 884.

lapsed as to that portion of the subject property.[107]

VI. LANDLORD/TENANT

A. TRADE FIXTURES

In *C.W. 100 Louis Henna, Ltd. v. El Chico Restaurants of Texas, L.P.*,[108] the issue was whether air conditioning units were trade fixtures or part of the improvements. El Chico, as the tenant, entered into a ground lease with Henna, the landlord, requiring the tenant to construct a building on the leased property pursuant to plans and specifications approved by the landlord. El Chico terminated its operations at the property, but continued to pay rent. After the expiration of the lease term, Henna sued El Chico for failing to maintain and repair certain air conditioning units which had been vandalized by copper theft and damaged by hail. The court concluded the air conditioning units were trade fixtures and El Chico was not responsible for their repair, based primarily on the language in the lease that provided that trade and business fixtures were not deemed to be part of the premises but remained the property of the tenant.[109] The lease defined "Premises" to be the land and improvements, but not "trade or business fixtures."[110] Without providing a specific definition, the drafters were considered to have intended the well established definition of same under Texas law.[111] El Chico presented uncontroverted evidence that the air conditioning units were not attached to the building and were readily removable. On the other hand, the landlord emphasized the inclusion of the specified air conditioning units in the plans and specifications for the construction of the improvements. The court held that inclusion of air conditioning units in the plans and specifications was irrelevant since the plans and specifications also included descriptions of the tenant's walk-in coolers, freezers, tables and chairs, and other trade fixtures and restaurant equipment.[112] Therefore, the exclusion of trade or business fixtures from the definition of improvements, without further describing what was intended, required the conclusion that the air conditioning units would be considered trade or business fixtures under the definition commonly used.[113] The *Henna* decision acknowledged that air conditioning units can be either trade fixtures or improvements depending upon facts and circumstances or the written contract.[114] Consequently, practitioners should take this uncertainty into

107. *Id.*

108. C.W. 100 Louis Henna, Ltd. v. El Chico Rest. of Tex., L.P., 295 S.W.3d 748, 750 (Tex. App.—Austin 2009, no pet.).

109. *Id.* at 758.

110. *Id.* at 754.

111. *Id.* at 754–55. In general, trade fixtures are personality annexed to realty by the tenant to enable him to carry on a trade, profession or enterprise.

112. *Id.* at 757.

113. *Id.* at 758.

114. *Id.* at 756.

account in drafting lease provisions by clearly defining what does and does not constitute trade fixtures.

B. Purchase Option

In *Moosavideen v. Garrett*,[115] the court faced the issue of whether the election of a purchase option contained in a lease was invalidated by a subsequent default under the lease. The tenant, Moosavideen, sent a notice advising the landlord of the intention to exercise the purchase option.[116] The lease gave the lessee the right "at any time within a period of the term of this lease, to purchase the interest of Lessor in and to the demised premises . . ."[117] One of the intervening tenants was Texaco, which was responsible for certain environmental contamination of the property. After the purported purchase option election by Moosavideen, the landlord gave notice of default based on such environmental contamination. In addressing this issue, the court concluded that the tenant was entitled to exercise the option at any time during the lease term because compliance with other terms and provisions of the lease was not a condition precedent to his right to exercise the lease-purchase option.[118] The court considered numerous other case authorities and concluded that the language of the option would govern what conditions were applicable to a proper exercise.[119] If compliance with other terms and provision of the lease were not conditions to the exercise of the option, then the election does not require compliance with the other provisions of the lease.[120] However, in *Tidwell v. Lange*,[121] the purchase option specifically conditioned the purchase option on the lessee not being in default. Since the parties in *Moosavideen* failed to specify any such conditions, the court concluded the purchase option was duly exercised and not impacted by an alleged default under the lease.[122] This case further exemplifies the need for careful drafting of instruments, particularly purchase options. Any conditions to such options must be clearly spelled out in unambiguous terms in the written contract.

VII. CONSTRUCTION MATTERS

Most of the construction-related cases during the Survey period were uniquely factual or procedural and are not reported here, but a number did address nuances of construction law practice and are instructive to the

115. Moosavideen v. Garrett, 300 S.W.3d 791, 793 (Tex. App.—Houston [1st Dist.] 2008, pet. denied).

116. *Id.* at 795. The subject lease had been executed many years before, and the current landlord was numerous heirs of the original landlord. The case discusses whether proper notice was given to each of the heirs who were currently landlords, but a discussion of such point is irrelevant to the subject topic.

117. *Id.* at 794.

118. *Id.* at 799.

119. *Id.* at 799–801.

120. *Id.* at 799 (citing Cook v. Young and Giblin v. Sudduth).

121. Tidwell v. Lange, 531 S.W.2d 384, 385 (Tex. Civ. App.—Waco 1975, no writ).

122. *Moosavideen*, 300 S.W.3d at 801.

practitioner. First, *JPMorgan Chase Bank, N.A. v. Texas Contract Carpet, Inc.*,[123] addressed the Construction Trust Fund Act and the meaning of "trustee" pursuant to a trust indenture for bond proceeds. The court found that the plain language of the Act exempts lenders, and further, that the lender was not a trustee, not an agent of the owner, and not a fiduciary to a subcontractor.[124] This was in spite of the fact that the lender controlled the construction account proceeds and retainage.[125] Funds in the construction account were owned and held for the benefit of the bondholder alone, and subcontractors had no right of ownership or possession to those funds.[126] Thus, even though the owner arguably contracted away the attributes of an owner, the statute was left lacking in this regard—a question for the legislature, not the court.[127]

Two cases dealt with governmental entities and construction activities. In *City of Carrollton v. RIHR, Inc.*,[128] the city's refusal to issue a building permit to the owner unless the owner provided funding for remediation of a separate retaining wall amounted to an "exaction" in violation of the Takings Clauses of the Federal and Texas Constitutions. The conduct of the city was a "compensatory regulatory taking" because the city failed to demonstrate a legitimate connection between remediation of the collapsed wall and the building permit for completion of residential construction on lots separate from the retaining wall remediation.[129] Also, in *Harris County Flood Control District v. Great American Insurance Co.*,[130] the governmental entity waived immunity from liability by entering into a contract. However, the contract did not specifically provide for attorney fees in the event of conflict, and attorney fees were not recoverable because governmental immunity was not waived as to that claim.[131] Moreover, quantum meruit did not lie because there had been no waiver of governmental immunity.[132] The dissent pointed out that the claim for attorney fees was only a remedy and part of a breach of contract action.[133]

In two procedural cases, courts pointed out two lessons for trial counsel. In the first, *Okorafor v. Uncle Sam & Associates, Inc.*,[134] the defendant owner waived the right to arbitration by pursuing an aggressive

123. JPMorgan Chase Bank, N.A. v. Texas Contract Carpet, Inc., 302 S.W.3d 515 (Tex. App.—Austin 2009, no pet.).
124. *Id.* at 528, 536.
125. *Id.* at 536.
126. *Id.*
127. *Id.* at 529.
128. City of Carrollton v. RIHR, Inc., 308 S.W.3d 444, 452 (Tex. App.—Dallas 2010, pet. filed).
129. *Id.* at 449–50.
130. Harris County Flood Control Dist. v. Great Am. Ins. Co., 309 S.W.3d 614, 616 (Tex. App.—Houston [14th Dist.] 2010, pet. denied).
131. *Id.* at 618.
132. *Id.* at 617.
133. *Id.* at 619.
134. Okorafor v. Uncle Sam & Assoc., Inc., 295 S.W.3d 27, 41 (Tex. App.—Houston [1st Dist.] 2009, pet. denied).

litigation strategy before seeking arbitration. The court found that the owner had waived the right to arbitration.[135] The owner amended the pleadings to seek affirmative relief, sent discovery and received responses, and then moved for arbitration before it had to answer discovery.[136] Also, in *Galbraith Engineering Consultants, Inc. v. Pochucha*,[137] the court found that while the party might designate another third party as a responsible third party for tort and deceptive trade practices actions, such a right to do so did not act to revive a claim otherwise barred by a statute of repose. Thus, even though joinder was barred, the responsible third party provision was separate and applicable. Likewise, even though the responsible third party procedure was available, it would not revive a cause of action barred by a statute of repose. The court carefully distinguished a statute of limitations, a time bar to asserting a claim, from a statement of repose, a substantive right to be free from liability after a predetermined time.

Finally, the U.S. Bankruptcy Court, Western District of Texas, addressed the issue of notices under mechanic's lien statutes and the automatic stay. In *In re Medina*,[138] a supplier sent a "Notice of Intent To File Lien" to the owner pursuant to the "trapping" provisions in chapter 53 of the Texas Property Code. The notice also incorporated a demand for payment to the owner as permitted by the statute.[139] The owner had also taken on the role of original contractor and offset payments post-petition to the subcontractor that had incurred the debt. Apparently, post-petition, the owner had chosen to continue with the subcontractor in bankruptcy. The court distinguished the trapping notices from a garnishment or other action against the debtor/subcontractor and found that 11 U.S.C. § 362 did not prohibit the demand by the supplier.[140] The owner was motivated to withhold funds to avoid personal liability and to avoid the filing of the affidavit of lien.[141] Thus, there was direct responsibility and liability, and the owner was authorized to undertake the offset, which it did. A supplier's notice of claim and demand for payment pursuant to Chapter 53 of the Texas Property Code were not actions to recover a claim against the debtor as such, but were rather actions to recover from the owner on account of a claim against the debtor.[142] This action had a clear independent basis and was not stayed by Section 362.[143]

135. *Id.*
136. *Id.* at 40.
137. Galbraith Eng'g Consultants, Inc. v. Pochucha, 290 S.W.3d 863, 868–64 (Tex. 2009).
138. *In re Medina*, 413 B.R. 583, 587 (Bankr. W.D. Tex. 2004).
139. TEX. PROP. CODE ANN. § 53.083(a) (West 2007).
140. *In re Medina*, 413 B.R. at 595–96.
141. *Id.* at 597.
142. *Id.* at 596.
143. *Id.*

VIII. TITLE MATTERS

A. TITLE DISPUTES

In *Lile v. Smith*,[144] the court of appeals reversed the trial court, which had found for the plaintiff in connection with a title dispute pursuant to a declaratory judgment action. The court noted that "trespass to try title is the exclusive remedy by which to resolve competing claims to property."[145] The court also noted that a specific identifiable piece of property was in dispute, and this was not just a boundary matter.[146] The court of appeals was correct, but the confusion over trespass to try title and declaratory judgment continues.

In *Fleming v. Patterson, Land Commissioner of the State of Texas*,[147] the court first found that an alleged declaratory judgment action was in actuality a trespass to try title. Then, the court felt bound to follow *Texas v. Lain*,[148] which held there was no sovereign immunity available to an individual official. In order to determine the plea to the jurisdiction, the court had to consider the title issues.[149] Essentially, because the only title evidence presented at the plea to jurisdiction hearing was by the State, the State prevailed as to the trespass to try title.[150] Two lessons may be learned—an official does not have sovereign immunity and the decision on jurisdiction will be based on an evidentiary hearing that may determine the merits.

Two other cases addressed the factual support necessary in connection with imposing charges against property. One dealt with imposing a constructive trust and the other dealt with the application of the doctrine of subrogation. In *In re Marriage of Harrison*,[151] a constructive trust could not be imposed unless the trust fund was clearly traced into other specific property. An exception lies when the trustee, the wrongdoer, mingles the trust funds with his own property or invests it in such a manner that the trust funds can no longer be segregated or identified.[152] However, at a minimum, in order to impose a constructive trust, the funds which were the subject of the constructive trust must be traced into the specific property sought to be encumbered.[153]

In *Chase Home Finance, LLC v. CAL Western Reconveyance Corp.*,[154] the court also addressed the evidence sufficient to prove up subrogation

144. Lile v. Smith, 291 S.W.3d 75, 76 (Tex. App.—Texarkana 2009, no pet.).
145. *Id.* at 77.
146. *Id.* at 78.
147. Fleming v. Patterson, 310 S.W.3d 65, 69 (Tex. App.—Corpus Christi 2010, pet. struck).
148. Texas v. Lain, 349 S.W.2d 579, 586 (Tex. 1961).
149. *Id.* at 70–71.
150. *Id.* at 71.
151. *In re* Marriage of Harrison, 310 S.W.3d 209, 214 (Tex. App.—Amarillo 2010, pet. denied).
152. *Id.* at 213.
153. *Id.*
154. Chase Home Fin., LLC v. CAL W. Reconveyance Corp., 309 S.W.3d 619, 632 (Tex. App.—Houston [14th Dist.] 2010, no pet.).

to a prior lien. The court addressed a theory commonly raised by those opposed to subrogation, that is, whether actual or constructive knowledge by a successor would defeat the right to subrogation and whether any negligence of the successor was relevant to the subrogation analysis.[155] The court followed the strong subrogation law in Texas, noting that the junior lienholder and its predecessors-in-interest were not prejudiced if the new lender was granted subrogation.[156] The court also noted the express deed of trust contractual subrogation provisions, even though the junior lien holder was not a party.[157] In this case, the lender seeking subrogation included documentation showing the payoff of the prior lien, the closing statement, the lender's disbursement worksheet, a release of the prior lien, and a demonstration that the proceeds of the lender's note were used to pay off the prior lien.[158] Also, often an issue with subrogation cases, the subrogation amount at the time of the lawsuit was "the payoff amount plus [the] legal interest thereon from date of the payment."[159] The subrogation amount was not limited to the original principal amount of the prior debt, nor was it entitled to the interest rate of the successor debt.[160]

B. Deeds and Conveyances

In one of the most important cases during the Survey period, *Myrad Properties, Inc. v. LaSalle Bank N.A.*,[161] the Texas Supreme Court addressed correction deeds and may have created more questions than answers. In summary, while trying not to be "blind to the equities of this dispute," the supreme court reached well beyond the foreclosure controversy at hand and held that a correction deed could not be used to add a second omitted tract intended to be part of a conveyance.[162] At the same time, in view of the "clear" mutual mistake, rescission of the foreclosure was warranted.[163] This left open questions of whether a rescission must be by judicial action and whether there could have been rescission if a third-party had purchased the property at foreclosure. The supreme court did mention disputed and unclear facts as to whether there were third-party bidders,[164] but ultimately determined that this was not relevant, arguably because the lender was the successful purchaser and a new sale would permit the potential bidders to rebid.[165] The supreme court did find that LaSalle made the sole bid at the foreclosure auction—again raising the question whether a different result would have been obtained

155. *Id.* at 631.
156. *Id.* at 6321–32.
157. *Id.* at 631.
158. *Id.* at 632.
159. *Id.* at 633.
160. *Id.*
161. Myrad Prop., Inc. v. LaSalle Bank N.A., 300 S.W.3d 746,748 (Tex. 2009).
162. *Id.* at 752–53.
163. *Id.* at 753.
164. *Id.* at 748 n.2.
165. *Id.*

had there been other bids at the auction.[166]

It has long been the law that a correction document could not affect third-party rights, but the suggestion that two parties to a transaction cannot correct a legal description to include additional property is new to the law and common practice. Texas has strong laws protecting bona fide parties such as purchasers and creditors, and the supreme court's finding that a correction document would undermine the purpose of record notice, due to a possible relation back doctrine, is arguably misplaced.[167] There would still be a later recorded notice subordinate to a bona fide party's claims. The supreme court also failed to address the issues of equitable title which might arise under such circumstances. The supreme court's holding, in context, is correct but should have been limited to the foreclosure setting. The supreme court also made the questionable finding that the lender and substitute trustee were parties to the conveyance and that the borrower was not, but there was no examination of the deed of trust.[168] Ostensibly, the supporting mutual mistake for the rescission would not be present if there had been a third-party purchaser. Certainly, the borrower and third parties are affected when a public sale is conducted. A judicial rescission might well be the appropriate remedy when such a mistake is made,[169] but again, it could have been limited to that setting because of the potential impact on third parties.

However, now the supreme court has broadly proclaimed "[u]sing a correction deed to convey an additional, separate parcel of land is beyond the appropriate scope of a correction deed."[170] Thus, parties will either need to correct a deed by utilizing court proceedings, or utilize a second deed to convey the omitted tract, leaving for subsequent litigation the questions of equitable title and competing claims to the property. Did the supreme court misunderstand the significance, or limitations thereon, of record notice in Texas? Certainly the supreme court looked for a result which would address and correct a potential inequity and windfall to the borrower.[171] In doing so, the supreme court may have gone well beyond the scope, in order to address the potential unjust enrichment to the borrower.[172]

At the same time, the Amarillo Court of Appeals in *KCCC Properties, Inc. v. Quality Vending, Inc.*,[173] followed *Myrad* and affirmed a trial court reformation of a deed to convey only tract one instead of the original tracts one and two. Again, the *KCCC Properties* case involved a dispute over transfer of property and a lawsuit between the grantor and

166. *Id.* at 748.
167. *Id.* at 750.
168. *Id.* at 752.
169. *Id.* at 751.
170. *Id.* at 750.
171. *Id.* at 752–53.
172. *See id.* at 753.
173. KCCC Props., Inc. v. Quality Vending, Inc., 312 S.W.3d 231, 236–37 (Tex. App.—Amarillo 2010, pet. denied).

grantee.[174] Note that *Myrad* would appear to require a grantor and grantee to file a lawsuit to reform an incorrect deed, even when the parties are in agreement.

The importance of legal descriptions continued to be a theme in other cases during the Survey period. In *Lowell v. Daniel*,[175] a deed was void for lack of a starting point and angles. Reference to extrinsic resources not referenced in the deed was not permitted.[176] However, in *Wiggins v. Cade*,[177] the court found that a reference in the deed to the name of the adjoining owner was sufficient, in that it allowed the individual to use parol evidence to locate the property. The deed indicated that the property began at the "[n]orthwest corner of the tract of 45 acres of land formerly owned by Mrs. Kate Crook."[178] By searching the grantor and grantee indices in the county deed records, one was able to identify the property survey name and abstract number.[179] Then, with that information, the land described in the two royalty deeds could be described with reasonable certainty.[180] The contesting party argued a subtle difference—that the deed must furnish within itself, or by reference to another existing writing, the means or data by which the land to be conveyed may be identified with reasonable certainty.[181] The court permitted the use of parol evidence, to connect data described in the instrument such as the name of the landowner to establish the sufficiency of the legal description.[182]

Another drafting lesson arises in the context of *Masgas v. Anderson*,[183] in which the granting clause was broader than the warranty clause. The assignment, or deed, included an attached "Exhibit A" identifying seven oil and gas leases, fractional interests, and disputed interests.[184] The assignment was intended, or so argued by the grantor, to only assign a fractional interest, noted on Exhibit A and to retain title to the "disputed working interests."[185] However, the granting clause indicated that the assignor "sells, transfers, assigns and conveys . . . all of the grantor's right, title and interest in . . . the oil and gas leases described in Exhibit A."[186] There was no reference or limitation to just the fractional interests.[187] The warranty did limit the warranty to the fractional interests, but the

174. *Id.* at 233.
175. Lowell v. Daniel, 293 S.W.3d 764, 769 (Tex. App.—San Antonio 2009, pet. denied).
176. *Id.* at 768. ("Location is an essential element of a deed which cannot be supplied by extrinsic evidence.").
177. Wiggins v. Cade, 313 S.W.3d 468, 473 (Tex. App.—Tyler 2010, pet. denied).
178. *Id.* at 471.
179. *Id.* at 472–473.
180. *Id.* at 473.
181. *Id.* 472–73.
182. *Id.*
183. Masgas v. Anderson, 310 S.W.3d 567, 571 (Tex. App.—Eastland 2010, pet. denied).
184. *Id.* at 573.
185. *Id.*
186. *Id.*
187. *Id.*

end result was that the grantor assigned all of its interest in the leases while only warranting the fractional interests.[188]

A number of courts also tackled the bona fide purchaser doctrine during the Survey period. Relevant to the *Myrad* decision, the Houston Court of Appeals in *Jones v. Smith*[189] found that a replacement deed was ineffective when the grantee already had acquired notice of a prior unrecorded transfer. The trial court was reversed because it had based its findings on a first-to-record theory, which as the court of appeals noted, is not the law in Texas.[190] The court also noted questions as to the timing of consideration, which is also a necessary element of bona fide purchaser status.[191]

Similarly, one that takes by reason of a quitclaim cannot achieve bona fide purchaser status.[192] In *Enerlex, Inc. v. Amerada Hess, Inc.*,[193] the deed conveyed "all right, title and interest in and to all of the Oil, Gas and any other classification of valuable substance . . . ." The deed also provided "[i]t is the intent of Grantor to convey all interest in the said county whether or not the [said] sections or surveys are specifically described herein."[194] A standard warranty clause was also included. Because the deed referenced "all right" as opposed to "my right," the grantee contended that this was a warranty deed.[195] The court, on the other hand, found it significant that the deed never warranted or represented that the grantor actually owned any mineral interest.[196] Viewing the deed in its entirety, the court found that the grantor never undertook to convey the property or assert that it owned, but rather only conveyed its right, title, and interest.[197] Thus, this was a quitclaim and the grantee could not be a bona fide purchaser.

The Eastland Court of Appeals again took on the characterization of deeds and bona fide purchaser status in *Bright v. Johnson*,[198] but in reaching its conclusion, arguably relied on an incorrect statement of law. The author of the *Enerlex* case, Judge Rick Strange, dissented in the *Bright* case. In *Bright*, a scrivenor's error failed to reserve or retain minerals in a warranty deed.[199] The grantee acknowledged that he had agreed that the grantors should keep the minerals and believed that they had.[200] However, the grantee's son intervened, claiming one-half of the

188. *Id.*
189. Jones v. Smith, 291 S.W.3d 549, 554 (Tex. App.—Houston [14th Dist.] 2009, no pet.).
190. *Id.*
191. *Id.* at 555.
192. Enerlex, Inc. v. Amerada Hess, Inc., 302 S.W.3d 351, 355 (Tex. App.—Eastland 2009, no pet.).
193. *Id.* at 354.
194. *Id.*
195. *Id.*
196. *Id.*
197. *Id.* at 355.
198. Bright v. Johnson, 302 S.W.3d 483, 485 (Tex. App.—Eastland 2009, no pet.).
199. *Id.* at 484–85.
200. *Id.* at 485.

minerals. After the grantor filed the lawsuit and a notice of lis pendens, the grantee and his son executed and caused to be recorded two "corrected" deeds without warranty that conveyed to the son one-half of the grantee's interest. Of some confusion, the sales contract indicated that

"the property [would be] conveyed subject to the following exceptions, reservations, conditions and restrictions. (if none, insert 'none')."[201]

A. Minerals, Royalties, and Timber Interests:

(1) Presently outstanding in third parties: None ["None" was written in];[202]

(2) To be *additionally retained* by Seller: "*All* of Record.[203]

The court found that this was an indication of the intent of the parties that the grantor was to retain all minerals of record and that the conveyance was to be made subject to those matters.[204] There were third-party interests previously of record which were not to be retained, but which should have been an exception to the property conveyed.[205] In essence, the court found that the use of the contractual term retained was not any different than reserved because the parties to the contract agreed that there was a mutual mistake.[206] The court found itself able to disregard conflicting precedent and reformed the deed to reflect the parties' intent that the grantor retain any minerals.[207]

Before the lawsuit and lis pendens were filed, the son of the grantee had entered into a contract to purchase one-half of his dad's interest. No deed was given and subsequent to the filing of the lawsuit, the father (grantor) provided a deed, without warranty, to the son. The son argued that he was a bona fide purchaser with equitable title much earlier pursuant to the earlier contract. The court decided that the earlier contract was at best a quitclaim deed because of phraseology in the agreement indicating that "I am selling" or "I have agreed to sell."[208] The court also made a broad statement that a subsequent purchaser could not be a bona fide purchaser "if the conveyance is made without warranty."[209] In support thereof, the court cited to quitclaim cases, not the same instrument at all.[210] The court may well have reached the correct decision based upon consideration and notice issues, but the statement about the lack of bona fide purchaser status to a grantee pursuant to a deed without warranty is inconsistent with Texas law.

Judge Strange noted the logic of the results but dissented primarily because the parties failed to ask the court to reform the underlying

201. *Id.* at 486.
202. *Id.*
203. *Id.* (emphasis in the original).
204. *Id.* at 486–87.
205. *Id.* at 487.
206. *Id.* at 487–88.
207. *Id.* at 491.
208. *Id.* at 492.
209. *See id.*
210. *Id.*

purchase agreement.[211] Judge Strange determined that the use of "all of record" was not the same as "all," and the contract could not be construed to reserve "all" of the minerals.[212] Had the grantee's son been a separate innocent third-party purchaser, the result would have been impractical. A bona fide purchaser could not be expected to investigate contracts, merger clauses, and the intent of the parties.

Finally, in *Longoria v. Lasater*,[213] the court spent much time discussing "perfect title," "record title," and "equitable interest." Moreover, the case includes a good discussion of an intended express trust and the implication of a resulting trust when that express trust fails.[214] The case is instructive for its discussion of these principles and terms.

C. Restrictive Covenants, Condominiums and Owners Associations

Holly Park Condominium Homeowners Ass'n v. Lowery,[215] demonstrates the importance of the review of the underlying documents before pursuing collection of unpaid dues. In this case, the condominium owner failed to pay the monthly assessment and the association proceeded to conduct a nonjudicial foreclosure. The Uniform Act in section 82.113(e) of the Texas Property Code gives the right to a condominium association to pursue a nonjudicial foreclosure.[216] However, in this case, the condominium by-laws provided for judicial foreclosure, and the court found that to control.[217]

In another case, *Duarte v. Disanti*,[218] the court explicitly stated that Chapter 82 of the Texas Property Code, regulating condominiums, does not provide for redemption when a foreclosure results in a sale to a third party. Such a right of redemption is provided to a homeowner in a property owners association by Chapter 209 of the Texas Property Code.[219] The court correctly pointed out that such extreme results for condominium owners also underscores the need for legislation to generally permit redemption by a condominium owner foreclosed for the nonpayment of dues or assessments.

Finally, in another case of interest, only for its interpretation of the commonly used term "pre-fabricated," the Amarillo Court of Appeals in *Letkeman v. Reyes*,[220] found that the commonly used term pre-fabricated was intended to ensure that homes would be of all new construction.

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211. *Id.* at 493.
212. *Id.* at 494.
213. Longoria v. Lasater, 292 S.W.3d 156, 165 (Tex. App.—San Antonio 2009, pet. denied).
214. *Id.* at 166–67.
215. Holly Park Condo. Homeowners Ass'n v. Lowery, 310 S.W.3d 144, 144–46 (Tex. App.—Dallas 2010, pet. denied).
216. Tex. Prop. Code Ann. § 82.113(e) (West 2007).
217. *Lowery*, 310 S.W.3d at 148–49.
218. Duarte v. Disanti, 292 S.W.3d 733, 734–35 (Tex. App.—Dallas 2009, no pet.).
219. *Id.* at 734.
220. Letkeman v. Reyes, 299 S.W.3d 482, 485 (Tex. App.—Amarillo 2009, no pet.).

Thus, pre-fabricated precluded moving a previously built home onto the property.[221] The home was an older home which had been cut in half into movable sections for later re-assembly in the subdivision. The pre-fabrication prohibition included such a home.[222]

D. HOMESTEAD

In *Fairfield Financial Group, Inc. v. Synnott*,[223] the Austin Court of Appeals abrogated its prior holdings in *Exocet, Inc. v. Cordes*[224] to follow Section 41.001(a)-(6) of the Texas Property Code, indicating that a judgment lien, even though properly abstracted, does not attach to the homestead. The *Exocet* court had followed a separate line of authority holding that a judgment lien did attach, but could not be asserted against homestead property so long as the property maintained its homestead character.[225] In *Fairfield Financial*, Connie Synnott remained in the home after Glenn Synnott moved out and filed for divorce. While Glenn and Connie were husband and wife, Fairfield Financial had obtained a judgment against Glenn and abstracted it. Fairfield Financial contended that, once the husband abandoned his homestead interest, the lien attached to his ownership in the property. Glenn, in the meantime, had transferred his ownership interest as part of the divorce to his ex-wife, Connie Synnott. The court found that the property remained at all times protected by Connie Synnott's undivided homestead interest in the property and that the judgment lien failed to ever attach.[226] Her homestead interest protected the entire property, and the judgment lien did not attach to any portion of the property.[227]

In 2008, Section 41.001 of the Texas Property Code was amended to make it clear that judgment liens did not attach to homesteads.[228] This decision leaves open the question of whether the judgment lien might attach to any continuing interest the husband might have had in the property after abandonment of the homestead position, such as a remainder interest. In this case, the husband transferred all of his interest to the wife.

The Eastern District of Texas, United States Bankruptcy Court, issued an important opinion in September of 2009 dealing with home equity loans.[229] This case discusses the homestead requirements under Section 50(a)(6) of the Texas Constitution in great detail and further discusses curative steps that may be taken.[230] While the court's discussion is bene-

221. *Id.*
222. *See id.* at 486.
223. Fairfield Fin. Group, Inc. v. Synnatt, 300 S.W.3d 316, 320 (Tex. App.—Austin 2009, no pet.).
224. Exocet, Inc. v. Cordes, 815 S.W.2d 350 (Tex. App.—Austin 1991, no pet.).
225. *See id.* at 352.
226. *Fairfield Fin. Group, Inc.*, 300 S.W.3d at 321–22.
227. *Id.* at 321.
228. *See id.* at 320; (citing TEX. PROP. CODE ANN. § 41.001(b) (West 2008)).
229. *In re* Chambers, 419 B.R. 652 (Bankr. E.D. Tex. 2009).
230. *Id.* at 668–69.

ficial for its great detail, most of it did not create any new precedent. The case involved a 2004 refinance and expansion of a 1999 home equity loan, including an expansion of the homestead collateral. A number of the normal issues, including subrogation, were included, but two very illustrative and important substantive points were made by the court.

First, the borrower raised a number of challenges to the 1999 home equity loan, but these were raised more than four years after the extension of the loan.[231] The court found that the borrower was barred by the four-year statute of limitations from bringing those challenges.[232]

Second, the borrower contended that the 2004 home equity loan included property that was not a homestead. Paragraph 4 of the "Texas Home Equity Deed of Trust" stated in pertinent part:

> This Extension of Credit is secured solely by the Homestead Property. Neither Lender nor any other party has required any collateral other than the Homestead Property to secure this Extension of Credit.
>
> Any provision contained in this Security Instrument and any other document between the parties or with any third party . . . which gives Lender a security interest in any personal or real property other than the Homestead Property, shall not apply to this Extension of Credit.[233]

The court found that to the extent that the lien encumbered non-homestead property in violation of Section 50(a)(6)(H), that defect was automatically cured by this language in the deed of trust.[234] Otherwise, the case involved a number of judicial admissions by reason of the borrower's bankruptcy filings and schedules such as a finding that the lender had timely tendered a cure, including a reclosing of the home equity loan.[235] Of some interest, the court supported the lender's position that it was not required to change the interest rate in connection with a reclosing and refinance.[236]

IX. MISCELLANEOUS

A. NUISANCE AND TRESPASS

In *Warwick Towers Council of Co-Owners v. Park Warwick, L.P.*,[237] the court addressed a distinction between trespass and nuisance. Also, the court separated the question of nuisance into permanent and temporary.[238] In this case, due to the significant rainfall arising in connection with tropical storm Allison, water flow into the hotel basement traveled

231. *Id.* at 680.
232. *Id.*
233. *Id.* at 677.
234. *Id.*
235. *Id.* at 679.
236. *Id.* at 678–79.
237. Warwick Towers Council of Co-Owners v. Park Warwick, L.P., 298 S.W.3d 436, 444, 447 (Tex. App.—Houston [14th Dist.] 2009, no pet.).
238. *Id.* at 445.

through a connecting tunnel to the condominium basement (the Warwick Towers) and caused significant damage. Warwick Towers sought recovery under theories of trespass and nuisance. The court affirmed the summary judgment on trespass, finding that a trespass to real property required a showing of unauthorized physical entry onto the plaintiffs' property by some person or thing.[239] Trespass was an intentional tort involving an intent to commit an act, and the alleged negligence of the hotel was not sufficient to support a trespass claim.[240]

However, in the context of nuisance, those claims were dependent upon the "kind of damage done, rather than [ ] any particular type of conduct."[241] The hotel argued that a nuisance theory would not lie because the alleged damage was a discreet flooding incident rather than a continuing repetitive event. The Houston Court of Appeals referred to *Schneider National Carriers, Inc. v. Bates*[242] and noted that a temporary nuisance claim could arise in appropriate circumstances from a one-time injury or isolated occurrence. While a temporary nuisance characterization would affect the nature of the damages recoverable, accrual, and even limitations, the single incident of flooding could sustain the temporary nuisance claim for the damages incurred.[243]

Also of interest, in *Hot Rod Hill Motor Park v. Triolo*[244] the court issued a permanent injunction against conducting races of motorized vehicles on a nuisance theory. However, once the homeowner plaintiff moved away, the court found a lack of sufficient occupancy interest and thus no further entitlement to injunctive relief.[245] This, of course, raises a question as to whether in such situations the court has created a requirement that homeowners continue to bring lawsuits in order to maintain such an injunction in the event that putative plaintiffs no longer live in the neighborhood.

B. Premises Liability

The cases during the Survey period for premises liability do not raise significant issues of law, but a few do demonstrate how different courts may treat invitees. Two of the cases were Texas Supreme Court cases and are discussed herein. In *Scott & White Memorial Hospital v. Fair*,[246] a hospital visitor slipped on ice while returning to his car in the parking lot. Mr. Fair was an invitee, but the Fairs argued that ice posed an unreasonable risk of harm, a condition which the hospital had a duty to protect against. The supreme court found that naturally accumulating ice did not

239. *Id.* at 447–48.
240. *Id.* 448.
241. *Id.* at 444.
242. Schneider Nat'l Carriers, Inc. v. Bates, 147 S.W.3d 264, 280 (Tex. 2004).
243. *Park Warwick, L.P.*, 298 S.W.3d at 445–46.
244. Hot Rod Hill Motor Park v. Triolo, 293 S.W.3d 788, 789 (Tex. App.—Waco 2009, pet. denied).
245. *Id.* at 791.
246. Scott & White Mem'l Hosp. v. Fair, 310 S.W.3d 411, 411 (Tex. 2010).

constitute an unreasonable or unnatural dangerous condition.[247] However, in *Del Lago Partners, Inc. v. Smith*,[248] the owners and operators of a resort had a duty to an invitee to protect a guest at the bar from "imminent assaultive conduct" by fellow patrons. In this case, one group of bar patrons began a course of conduct including yelling, threatening, cursing, and shoving; the bar staff continued to serve drinks and did not call security. A fight broke out. While naturally occurring ice does not present an unreasonable risk of harm, apparently name calling and hand gesturing fraternity members may.[249] Justices Hecht, Johnson, and Wainwright filed dissents, questioning causation and whether the case was really a premises liability case (negligent activity as opposed to a physical condition or defect).[250] Justice Hecht, joined by Justice Johnson, also filed a dissenting opinion challenging the supreme court's decision as creating an undefined exception from the general rule that a possessor of land discharges his duty to protect an invitee from a condition that poses an unreasonable risk of harm by giving an adequate warning.[251] The supreme court's decision is the ultimate bar fight. The parties could have avoided the fight. The parties recognized the increasing tension and were aware of the potential for a fight. The parties willfully and intentionally engaged in the fight. But at that point the parties were obviously no longer responsible for their own conduct. This is not the case of an innocent bystander being injured, but rather an individual that joined in the fight and chose to do so. Thus, the question: at what point does an invitee become no longer responsible for his or her own knowing conduct?

On an entirely separate aspect of premises liability, in *City of Plano v. Homoky*,[252] the court discussed the Texas Recreational Use Statute, (foundation Section 75.001–.004 of the Texas Civ. Prac. & Rem. Code) and pointed out that the duty of the city as a premise owner is limited to that of the duty to a trespasser in a recreational use situation. In this situation, a golfer tripped over a board in the clubhouse that was placed to support large potted plants. The boards and planters were clearly visible, and the employee that placed the board and planters there did not think the situation created a danger. The employee also considered the safety of persons using the lobby when making the decision for the arrangement. Thus, the plaintiff failed to raise a fact question as to gross negligence, the standard required for liability to a trespasser, and the claim was dismissed on summary judgment.[253]

247. *Id.*
248. Del Lago Partners, Inc. v. Smith, 307 S.W.3d 762, 770 (Tex. 2010).
249. *Id.* at 764–65.
250. *Id.* at 785, 787.
251. *Id.* at 796.
252. City of Plano v. Homoky, 294 S.W.3d 809, 817 (Tex. App.—Dallas 2009, no pet.).
253. *Id.* at 818.

C. BROKERS

In *Lathem v. Kruse*,[254] a suit by a broker in a joint venture, which was based on a participation interest in profits, was characterized as a suit for compensation or commission in connection with the sale of property and governed by the Real Estate Licensing Act (RELA). Thus, once characterized as an action to recover a commission, it had to meet each of the written requirements of Section 1101.806.[255] In this case, there was no supporting writing because the broker had agreed to keep his commission "in the deal" and receive a percentage upon the sale of the property.[256] The broker thus contended that he was a joint venturer, but the court focused on whether the broker was seeking recovery of compensation due for the rendition of services governed by RELA without regard to what form the compensation took.[257] Because of a lack of a writing that met the requirements of RELA, the broker was not able to recover the claimed commission.[258]

D. WATER RIGHTS

The only non-procedural reported case involving water rights during the Survey period was *Solomon v. Steitler*.[259] This was a case involving diversion of surface water and damage to the property of another.[260] The jury found that the diversion was grossly negligent. Punitive damages were permitted by reason of a violation of Section 11.086 of the Texas Water Code.

X. CONCLUSION

Though there were no significant changes in real property law during the Survey period, there were a number of cases which are instructive and beneficial to the practitioner. Additionally, there were a number of cases which the authors have criticized, and may be subject to further analysis in the future. In summary, the following are the general legal developments and practical advice which can be taken from these cases:

1). Mortgagees should make prompt assessments and elections with respect to insurance proceeds after a casualty to the collateral property.

2). Fraudulent transfers of real property will be determined at the time of the deed and not at the time of a contract for conveyance.

3). The ongoing consternation between absolute and collateral assignment of rents has been resolved in the bankruptcy context pursuant to *In re Amaravathi*, which provides that all post-petition rents become prop-

254. Lathem v. Kruse, 290 S.W.3d 922, 927 (Tex. App.—Dallas 2009, no pet.) (citing TEX. OCC. CODE ANN. § 1101.806(c) (West 2004)).
255. *Id.* at 925.
256. *Id.* at 924.
257. *Id.* at 927.
258. *Id.*
259. Solomon v. Steitler, 312 S.W.3d 46, 50–51 (Tex. App.—Texarkana 2010, no pet.).
260. *Id.* at 50.

erty of the estate. This is probably the most significant case development during the Survey period.

4). The law on right of first refusal has probably been misanalyzed in *FWT*, and should be used carefully for precedential purposes; however, it does provide a detail analysis of leading cases in the multiple asset category of right of first refusal cases.

5). The use of correction deeds was addressed in *Myrad Properties* by the Texas Supreme Court; however, the supreme court may have created more questions than answers, and until further clarified, practitioners should be wary on the process of correcting deeds and must decide whether a court decision will be required.

6). In the homestead context, *Fairfield Financial* concluded that a homestead characterization is not lost as to a divorcing husband's one-half community interest conveyed to the occupying spouse; however, the court did not address the characterization and affect on the remainder interest if still held by a divorcing spouse after the property ceases to become a homestead of the occupying spouse.